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# AICPA Professional Standards: Standards for performing and reporting on peer reviews as of June 1, 1996

American Institute of Certified Public Accountants. Peer Review Board

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# **AICPA PROFESSIONAL STANDARDS**

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## **Volume 2**

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**Accounting & Review Services**

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**Code of Professional Conduct**

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**Bylaws**

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**International Accounting**

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**International Auditing**

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**Consulting Services**

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**Peer Review**

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**As of June 1, 1996**

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American Institute of  
Certified Public Accountants

PR Section

**STANDARDS FOR PERFORMING AND  
REPORTING ON PEER REVIEWS**

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**PR Section****STANDARDS FOR PERFORMING AND REPORTING ON PEER REVIEWS**

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**NOTICE TO READERS**

Members of the American Institute of Certified Public Accountants who are engaged in the practice of public accounting in the United States or its territories are required to be practicing as owners or employees of firms enrolled in an approved practice-monitoring program in order to retain their membership in the Institute beyond specified periods.

A firm enrolled in the AICPA peer review program or a member firm of the AICPA Division for CPA Firms is deemed to be enrolled in an approved practice-monitoring program. (See sections 2.2.3 and 2.3.4 of the bylaws of the AICPA and the implementing Council resolutions under those sections.)

In the fall of 1994, the AICPA Board of Directors and the AICPA Council approved the combination of the peer review program of the private companies practice section and the AICPA quality review program. At that time, the AICPA quality review program was renamed the AICPA peer review program and the executive committee, having senior status with authority to establish and conduct the review program in cooperation with state CPA societies, was renamed the AICPA Peer Review Board.

These standards are effective for reviews performed on or after April 3, 1995, of firms enrolled in the AICPA peer review program and of firms that are members of the private companies practice section. They are applicable to firms enrolled in these programs and to individuals and firms who perform and report on such reviews, to state CPA societies administering the reviews, and to associations of CPA firms assisting their members in arranging and carrying out peer reviews. Individuals using these standards should be knowledgeable about interpretations issued by the AICPA Peer Review Board which might impact the application of these standards.

Reviews of firms that are members of the SEC practice section of the AICPA Division for CPA Firms are carried out under the standards issued by the SEC practice section's peer review committee that address, among other things, the various membership requirements of the section applicable to audits of SEC clients.

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**PR Section 100*****Standards for Performing and Reporting on Peer Reviews***

Effective for reviews performed on or after April 3, 1995.

**Introduction**

.01 Quality in the performance of accounting and auditing engagements by AICPA members is the goal of the AICPA peer review program. The program seeks to achieve its goal through education and remedial, corrective actions. This goal serves the public interest and, at the same time, enhances the significance of AICPA membership.

.02 Participants in the AICPA peer review program need to—

- a. Understand what is necessary for quality practice.
- b. Establish appropriate quality control policies and procedures.
- c. Have an independent review of their accounting and auditing practices at least every three years.
- d. Take remedial, corrective actions as needed.

.03 Statement on Quality Control Standards (SQCS) No. 1, *System of Quality Control for a CPA Firm* [QC section 10],\* issued in November 1979, requires every CPA firm, regardless of its size, to have a system of quality control for its accounting and auditing practice. It identifies nine elements of quality control and states that a firm shall consider each of those elements, to the extent applicable to its practice, in establishing its quality control policies and procedures. In that connection, the statement recognizes that the nature and extent of a firm's quality control policies and procedures depend on a number of factors, such as its size, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, its organization, and appropriate cost-benefit considerations.

.04 The objectives of the AICPA peer review program are achieved through the performance of reviews involving procedures tailored to the size of the firm and the nature of its practice. Firms that perform audits of historical or prospective financial statements (*audits* of prospective financial statements are referred to as *examinations* in relevant professional standards) have on-site peer reviews, while firms that provide only compilation or review services have off-site peer reviews of selected reports on those services, unless they elect to have on-site peer reviews. Firms that do not provide those services are not reviewed.

.05 Upon completing a peer review, the review team prepares a written report and, when applicable, a letter of comments in accordance with these standards. The reviewed firm transmits these documents and, when applicable, a letter outlining its response to the review team's findings and recommendations to the state CPA society administering its review. These documents are not public documents, unless the firm is a member of the private companies practice section of the AICPA Division for CPA Firms. However, the reviewed firm may make them available to the public if it so chooses after

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\* SQCS No. 1 [QC section 10] will be superseded by SQCS No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* [QC section 20]. SQCS No. 2 [QC section 20] is applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 1997.

they have been formally accepted by the state CPA society administering the review.

.06 The program is based on the principle that a systematic monitoring and educational process is the most effective way to attain high-quality performance throughout the profession. Thus, it depends on mutual trust and cooperation. The reviewed firm is expected to take appropriate actions in response to significant deficiencies in its quality controls or in its compliance with them. These actions will be positive and remedial. Disciplinary actions (that is, actions that can result in the termination of a firm's enrollment in the peer review program or membership in the private companies practice section (PCPS) of the AICPA Division for CPA Firms, and the subsequent loss of membership in the AICPA by its owners and employees) will be taken only for a failure to cooperate or for deficiencies that are so serious that remedial or corrective actions are not suitable.

## General Considerations

### Enrollment Requirements

.07 At least one of the owners of a firm that seeks to be enrolled in the AICPA peer review program must be a member of the AICPA.<sup>1</sup>

### Confidentiality

.08 A peer review must be conducted in compliance with the confidentiality requirements set forth in the AICPA Code of Professional Conduct. Information concerning the reviewed firm or any of its clients or personnel, including the findings of the review, that is obtained as a consequence of the review is confidential. Such information should not be disclosed by review team members to anyone not involved in carrying out the review or administering the program, or used in any way not related to meeting the objectives of the program.

.09 It is the responsibility of the reviewed firm to take such measures, if any, as may be necessary to satisfy its obligations concerning client confidentiality any time state statutes or ethics rules promulgated by state boards of accountancy do not clearly provide an exemption from confidentiality requirements when peer reviews are undertaken.<sup>2</sup> In all cases, the reviewed firm may advise its clients that it will have a peer review and that accounting or auditing work for that client may be subject to review.

### Independence

.10 Independence must be maintained with respect to the reviewed firm by a reviewing firm, by review team members, and by any other individuals who participate in or are associated with the review. The concepts in the AICPA Code of Professional Conduct should be considered in making independence judgments. In that connection, the specific requirements set forth in appendix A [paragraph .79] apply.

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<sup>1</sup> Exhibit 1 [paragraph .78] includes summarized information from Section 1000 of the *PCPS Reference Manual*, "Organizational Structure and Functions of the Private Companies Practice Section," concerning the private companies practice section membership requirements and additional peer review requirements.

<sup>2</sup> The AICPA maintains a list of states, available upon request, that do not clearly provide such an exemption. That list and related guidance material for reviewed firms have been provided to state CPA societies.



## Conflict of Interest

.11 A reviewing firm or an individual participating in carrying out or administering a review must not have a conflict of interest with respect to the reviewed firm or those of its clients whose engagements are selected for review. Such firms and individuals should avoid contacts with clients or personnel of the reviewed firm that could be asserted to be evidence of a conflict of interest.

## Competence

.12 A review team conducting an on-site peer review must have current knowledge of the type of practice to be reviewed. Individuals reviewing engagements, on-site or off-site, must have a familiarity with the specialized industry practices, such as those found in the banking and insurance industries, of the clients that should be selected for review.

## Due Professional Care

.13 Due professional care must be exercised in performing and reporting on the review. This imposes an obligation on all those involved in carrying out the review to fulfill assigned responsibilities in a professional manner similar to that of an independent auditor examining financial statements.

## Administration of Reviews

.14 Reviews intended to meet the requirements of the AICPA peer review program must be carried out in conformity with these standards under the supervision of a state CPA society authorized by the AICPA Peer Review Board to administer peer reviews. This imposes an obligation on reviewed firms to arrange and schedule their reviews in compliance with the administrative procedures established by the applicable state CPA society, and to cooperate with the society and with the AICPA Peer Review Board in all matters related to the review.

## Organization of the Review Team

.15 A review team may be formed by a firm engaged by the firm under review (a firm-on-firm review) or by a state CPA society participating in the program (a committee-appointed review team). Also, the AICPA Peer Review Board may authorize an association of CPA firms to assist its members by organizing review teams to carry out on-site and off-site peer reviews (an association review).

.16 A review team comprises one or more individuals, depending upon the size and nature of the reviewed firm's practice. One member of the review team is designated the team captain. That individual is responsible for organizing and conducting the review, communicating the review team's findings to the reviewed firm and to the state CPA society administering the review,<sup>3</sup> and preparing the report and, if applicable, the letter of comments on the review. Team captains on on-site and off-site peer reviews should test the work performed by other reviewers to the extent deemed necessary in the circumstances.

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<sup>3</sup> The plan of administration adopted by an association of CPA firms that assists its members in arranging and carrying out peer reviews may provide that the association will communicate the review team's findings to the state CPA society administering the review.

## Qualifications for Service as a Reviewer

### General

.17 Performing and reporting on peer reviews requires the exercise of professional judgment by peers. Accordingly, an individual serving as a reviewer (whether for on-site or off-site peer reviews)<sup>4</sup> must be a member of the AICPA licensed to practice as a certified public accountant, must possess current knowledge of applicable professional standards, and must be currently active in public practice at a supervisory level in the accounting or auditing function of a firm enrolled in an approved practice-monitoring program (that is, a firm enrolled in the AICPA peer review program or a firm that is a member of the AICPA Division for CPA Firms) as one of the following:

- a. An owner of the firm
- b. A manager or person with equivalent supervisory responsibilities

### On-Site Peer Reviews

.18 All on-site review team members must have at least five years of recent experience in the practice of public accounting in the accounting and auditing function.<sup>5</sup> A team captain must be an owner of an enrolled firm and must have completed a training course or courses that meet requirements established from time to time by the AICPA Peer Review Board. A team captain must also be associated with a firm that has received an unqualified report on its system of quality control within the previous three years. A team captain should have a familiarity gained through personal experience with the types of problems encountered by the reviewed firms.

.19 An individual who serves as the team captain for two successive reviews of the same firm may not serve in that capacity for the firm's next peer review.

.20 Where required by the nature of the reviewed firm's practice, individuals with expertise in specialized areas who need not be CPAs may assist the review team in a consulting capacity. For example, computer specialists, statistical sampling specialists, actuaries, or educators expert in continuing professional education may participate in certain segments of the review.

### Off-Site Peer Reviews

.21 All reviewers participating in off-site peer reviews (available to firms that perform no audits of historical or prospective financial statements) should have had at least five years of recent experience in the practice of public accounting in the accounting or auditing function<sup>6</sup> and must have completed a training course or courses that meet requirements established from time to time by the AICPA Peer Review Board. Off-site reviewers must also be associated with a firm that has received, within the three previous years, either of the following:

- a. An unqualified report on its system of quality control

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<sup>4</sup> See exhibit 1 [paragraph .78] for additional qualifications needed by individuals performing reviews of firms in the private companies practice section.

<sup>5</sup> The Peer Review Board recognizes that practitioners often perform a number of functions, including tax and consulting work, and cannot restrict themselves to accounting and auditing work. This standard is not intended to require that reviewers be individuals who spend all their time on accounting and auditing engagements. However, CPAs who wish to serve as reviewers should carefully consider whether their day-to-day involvement in accounting and auditing work is sufficiently comprehensive to enable them to perform a peer review with professional expertise.

<sup>6</sup> See footnote 5.

- b. A report on an off-site review that is not adverse or qualified for significant departures from professional standards

## Performing On-Site Peer Reviews

### Objectives

.22 An on-site peer review is intended to provide the reviewer with a reasonable basis for expressing an opinion on whether, during the year under review—

- a. The reviewed firm's system of quality control for its accounting and auditing practice met the objectives of quality control standards established by the AICPA (see Statement on Quality Control Standards (SQCS) No. 1 [QC section 10]\*).
- b. The reviewed firm's quality control policies and procedures were being complied with in order to provide the firm with reasonable assurance of conforming with professional standards.
- c. If applicable, the reviewed firm was complying with the membership requirements of the private companies practice section of the AICPA Division for CPA Firms in all material respects. (See exhibit 1 [paragraph .78] for a description of the membership requirements.)

.23 Firms that perform audits of historical or prospective financial statements must have on-site peer reviews because of the public interest in the quality of such audits and the importance to the accounting profession of maintaining the quality of those services.

### Basic Requirements

.24 An on-site peer review should include a study and evaluation of the quality control policies and procedures that the reviewed firm had in effect for its accounting and auditing practice during a period of one year mutually agreed upon by the reviewed firm and the team captain. If the reviewed firm is a member of the private companies practice section, the review also should include a review of the firm's compliance with the section's membership requirements. (See exhibit 1 [paragraph .78].) Ordinarily, the review year must not end before the end of the previous calendar year.

.25 Statement on Quality Control Standards (SQCS) No. 1 [QC section 10]\* requires every CPA firm, regardless of its size, to have a system of quality control for its accounting and auditing practice. It states that a firm shall consider each of the following elements of quality control, to the extent applicable to its practice, in establishing its quality control policies and procedures: independence, assigning personnel to engagements, consultation, supervision, hiring, professional development, advancement, acceptance and continuance of clients, and inspection. Accordingly, the review team should obtain a general understanding of the reviewed firm's quality control policies and procedures with respect to each of those nine elements of quality control. Ordinarily, this understanding can be obtained from reading the reviewed firm's responses to a questionnaire developed by the AICPA Peer Review Board. The review team should also perform appropriate compliance tests related to broad functions.

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\* SQCS No. 1 [QC section 10] will be superseded by SQCS No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* [QC section 20]. SQCS No. 2 [QC section 20] is applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 1997.

.26 In smaller firms, senior personnel of the firm are usually directly involved in decisions with respect to assignment of personnel, hiring, advancement, and acceptance and continuance of clients. Various factors inherent in their operations (for example, the limitations imposed by the size of the firm, the relative infrequency of certain events, or the informal, cooperative style of management that might be followed by the firm) may make it efficient and perhaps necessary for senior personnel to make those decisions based on the application of professional judgment in the specific circumstances rather than by the application of previously defined criteria and policies. Similarly, those firms may find that ongoing supervision and monitoring of their practices by senior personnel is an effective way to achieve many of the objectives of a formal inspection program. When those circumstances exist in firms with up to ten professionals (defined for this purpose as CPAs and those expected to seek that status) during the majority of the review year, the team captain would ordinarily decide to restrict compliance tests of broad functions (for example, tests of administrative and personnel files) to those related to independence, consultation, supervision, and professional development. This would be appropriate when the team captain concludes that the review of selected engagements and interviews with firm personnel will provide an adequate means of identifying failures, if any, to achieve the objectives inherent in the other five elements of quality control.

.27 An on-site peer review should also include—

- a. Review of selected engagements, including the relevant working paper files and reports, with fiscal years ending during the review year—unless a more recent report has been issued—constituting a reasonable cross section of the reviewed firm's accounting and auditing practice. If the reviewer notes significant deficiencies in the performance of such engagements or the reporting thereon, he or she should identify actions the firm should consider taking to provide the firm with reasonable assurance that such deficiencies will not recur. In that connection, it might be necessary for the reviewer to expand compliance tests of broad functions to identify such actions. In addition, the reviewed firm shall consider whether it is required to take additional actions under relevant professional standards whenever the review team believes that the firm's report on previously issued financial statements may be inappropriate or that the firm's work may not support the report issued. In such cases, the reviewed firm shall provide the review team with its conclusions in writing (generally on a "Matter for Further Consideration" form prepared by the reviewer).
- b. Attendance at an exit conference by senior members of the reviewed firm and at least the team captain to discuss the review team's findings and recommendations and the type of report it will issue.
- c. Preparation of a written report on the results of the review and, if applicable, a letter of comments (see "Reporting on Reviews" [paragraphs .56 through .68]).
- d. Preparation by the reviewed firm, if applicable, of a written response to the letter of comments outlining the actions the firm plans to take with respect to the recommendations made by the review team (see "Reporting on Reviews" [paragraphs .56 through .68]).
- e. Appropriate consideration of the results of the review by a duly constituted committee of a participating state CPA society. Such

consideration should include, where applicable, an evaluation of the adequacy of the corrective actions the firm has represented it will take and a determination on whether other remedial, corrective actions and/or monitoring of the firm's action plan should be required (see "Acceptance of Reviews" [paragraphs .69 through .76]).

.28 The AICPA Peer Review Board has authorized the issuance of programs and checklists, including engagement review checklists, to guide team captains and other members of the review team in carrying out their responsibilities under these standards. Failure to complete all relevant programs and checklists in a professional manner creates the presumption that the review has not been performed in conformity with these standards. Such a review cannot be accepted as meeting the requirements of the peer review program.

## Other Requirements

.29 The requirements set forth in the paragraphs that follow supplement the basic requirements set forth above.

## Scope of the Review

.30 The review should cover a firm's accounting and auditing practice which, for purposes of peer reviews under these standards, is limited to all engagements covered by Statements on Auditing Standards, Statements on Standards for Accounting and Review Services, the Statement on Standards for Attestation Engagements *Financial Forecasts and Projections* [AT section 200], and standards for financial and compliance audits contained in *Government Auditing Standards*, issued by the U.S. General Accounting Office (the "Yellow Book").

.31 The review should be directed to the professional aspects of the firm's accounting and auditing practice; it should not include the business aspects of that practice. Moreover, review team members should not have contact with or access to any client of the reviewed firm in connection with the review.

.32 The review team will be provided with basic background information about the reviewed firm by the state CPA society administering the review or, where applicable, an authorized association of CPA firms. The review team captain should consider whether to request other useful information from the firm in planning the review. In all cases, the team captain should obtain the report on the last review of the firm and, if applicable, the letter of comments and the response thereto, and the letter accepting those documents. The team captain should consider whether the matters discussed in those documents require additional emphasis in the current review, and in the course of the review should evaluate the actions of the firm in response to the prior report and letter of comments.

.33 A divestment of a portion of the practice of a reviewed firm during the year under review may have to be reported as a scope limitation if the review team is unable to assess compliance for reports issued under the firm's name during that year. A review team captain who is considering whether a peer review report should be modified in these circumstances should consult with the state CPA society administering the review.

.34 A reviewed firm may have legitimate reasons for not permitting the working papers for certain engagements to be reviewed. For example, the financial statements of an engagement selected for review may be the subject of litigation or investigation by a government authority, or the firm may have been advised by a client that it will not permit the working papers for its engagement to be reviewed. In such circumstances, the review team should satisfy itself as to the reasonableness of the explanation. Also, in order to reach a conclusion that the excluded engagements do not have to be reported as a scope limitation, the review team needs to consider the number, size, and relative complexity of the excluded engagements, and should review other

engagements in a similar area of practice as well as other work of the supervisory personnel who participated in the excluded engagements.

.35 In reviewing a practice office, the accounting and auditing practice to be reviewed includes reports issued for or to another office of the reviewed firm, a correspondent firm, or an affiliated firm. For those situations in which engagements selected in the practice office being reviewed include use of the work of another office, correspondent, or affiliate, the review team may limit its review to portions of the engagements performed by the practice office being reviewed, but should evaluate the appropriateness of the instructions issued by the reviewed office and the adequacy of the procedures followed to comply with professional standards.

### **Study and Evaluation of Quality Controls**

.36 The review team should begin its review with a study and evaluation of the reviewed firm's quality control policies and procedures over its accounting and auditing practice in relation to the guidance material contained in Quality Control Policies and Procedures for CPA Firms, *Establishing Quality Control Policies and Procedures* [QC section 90], and in the program for reviewers issued by the AICPA Peer Review Board. As previously stated, team captains on reviews of firms with up to ten professionals would ordinarily restrict compliance tests of broad functions to those related to the quality control elements of independence, consultation, supervision, and professional development. This study and evaluation, which should be continuously reevaluated during the course of the review, assist the review team in deciding whether the reviewed firm has adopted appropriately comprehensive and suitably designed policies and procedures that are relevant to the size and nature of its practice.

### **Extent of Compliance Tests**

.37 Based on its consideration of the background information provided by the firm, including the results of the last review of the firm, and on its study and evaluation of the reviewed firm's quality control policies and procedures, the review team should consider whether any modifications to the programs and checklists issued by the AICPA Peer Review Board are appropriate. The team captain should then develop a general plan for the conduct of the review, including the nature and extent of compliance tests. The compliance tests should be tailored to the practice of the reviewed firm and, taken as a whole, should be sufficiently comprehensive to provide a reasonable basis for concluding whether the reviewed firm's quality control policies and procedures were complied with to provide the firm with reasonable assurance of conforming with professional standards in the conduct of its accounting and auditing practice. Such tests should be performed at the practice office(s) visited and should relate either to broad functions or to individual engagements. The tests should include—

- a. Review of selected engagements, including working paper files and reports, to evaluate their conformity with professional standards and compliance with relevant firm quality control policies and procedures in their conduct.
- b. Interviews with firm professional personnel at various levels and, if applicable, other persons responsible for a function or activity, to assess their understanding of and compliance with the firm's quality control policies and procedures.
- c. Obtaining other evidential matter as appropriate, for example, by review of selected administrative or personnel files, correspondence

files documenting consultations on technical or ethical questions, files evidencing compliance with continuing professional education requirements, and the firm's library.

### **Selection of Offices**

.38 The process of office selection in a multi-office firm involves the exercise of considerable professional judgment. Visits to practice offices should be sufficient to enable the review team to evaluate whether the firm's quality control policies and procedures are adequately communicated throughout the firm and whether they are being complied with. Accordingly, the practice offices visited should provide a reasonable cross section of the reviewed firm's accounting and auditing practice, and the office selection process should include consideration of the following factors:

- a. Number, size, and geographic distribution of offices
- b. The degree of centralization of accounting and auditing practice control and supervision
- c. The review team's evaluation, where applicable, of the firm's inspection program
- d. Recently merged or recently opened offices
- e. The significance of industry concentrations (including concentrations of engagements in high-risk industries) and of specialty practice areas, such as governmental compliance audits or regulated industries, to the firm and to individual offices

.39 Although the process of office selection is not subject to definitive criteria, a review team should select at least one of the larger offices and one to three others in a multi-office firm with up to fifteen offices and 15 to 25 percent of the offices in a firm with more than fifteen offices.

.40 Reviewers should ask the state CPA society administering the review about any requirements of relevant state boards of accountancy that must be met for the review to be accepted by such state board(s) as the equivalent of one performed under the state board's own positive enforcement program.

### **Selection of Engagements**

.41 When combined with other procedures performed, the number and type of accounting and auditing engagements selected by the review teams for review (see "Scope of the Review" [paragraphs .30 through .35]) should be sufficient to provide the review team with a reasonable basis for its conclusions regarding whether the reviewed firm's quality control system met the objectives of quality control standards established by the AICPA and was being complied with during the year under review.

.42 Engagements selected for review should provide a reasonable cross section of the reviewed firm's accounting and auditing practice. However, the number of review and compilation engagements selected for review may be significantly limited when a substantial portion of the firm's accounting and auditing hours are devoted to audit engagements. Also, greater weight should be given to audit engagements that meet the following criteria:

- a. Engagements in which there is a significant public interest, such as publicly held clients, financial and lending institutions, brokers and dealers in securities, and employee benefit plans
- b. Engagements in other specialized industries
- c. Engagements that are large, complex, or high-risk or that are the reviewed firm's initial audits of clients



In addition, the sample of engagements selected for review should include at least one audit conducted pursuant to *Government Auditing Standards*.<sup>7</sup>

.43 Although the process of engagement selection, like office selection, is not subject to definitive criteria, the review team generally should review work that represents 5 to 10 percent of the accounting and auditing hours of the reviewed firm. However, the review team will frequently find that meeting all of the criteria discussed above would cause it to select engagements representing accounting and auditing hours substantially in excess of these percentage guidelines. In such circumstances, the review team should carefully consider whether—

- a. Adequate consideration has been given to the *key audit area* approach to engagement review. (This is discussed more fully in the AICPA programs and checklists.)
- b. Too much weight is being given to the desirability of reviewing work performed by all or most supervisory personnel.
- c. Adequate consideration has been given to engagement selection on a firm-wide basis. For example, if two offices are selected for review and each has a large client in the same specialized industry, consideration should be given to selecting only one of those engagements for review.

### Extent of Engagement Review

.44 The review of engagements should include review of financial statements, accountants' reports, working paper files, and correspondence, as well as discussions with professional personnel of the reviewed firm. The review of audit engagements should ordinarily include all key areas of the engagements selected to determine whether well-planned, appropriately executed, and suitably documented procedures were performed in accordance with professional standards and the reviewed firm's quality control policies and procedures.

.45 For each engagement reviewed (audits, reviews, and compilations), the review team must document whether anything came to its attention that caused it to believe that—

- a. The financial statements were not presented in all material respects in accordance with generally accepted accounting principles (or, if applicable, an other comprehensive basis of accounting).
- b. The firm did not have a reasonable basis under applicable professional standards for the report issued.
- c. The documentation on the engagement did not support the report issued.
- d. The firm did not comply with its quality control policies and procedures in all material respects.

.46 If the review team reaches a negative conclusion with respect to items a, b, or c, the team captain should promptly inform an appropriate member of the reviewed firm (generally on a "Matter for Further Consideration" form). The reviewed firm should investigate the matter questioned by the review team and determine what action, if any, should be taken. The reviewed firm should advise the team captain of the results of its investigation and document the actions taken or planned or its reasons for concluding that no action is required. If the reviewed firm believes that it can continue to support its

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<sup>7</sup> Reviewers should be alert to peer review standards interpretations [section 9100] developed by the Peer Review Board that might affect the engagements selected for review.

previously issued report and the review team continues to believe that there may be a significant failure to reach appropriate conclusions in the application of professional standards, the review team should pursue any remaining questions with the reviewed firm and, if necessary, with the state CPA society administering the review. The review team should also consider whether it is necessary to expand the scope of the review by selecting additional engagements to determine the extent and cause of significant departures from professional standards.

.47 In evaluating the reviewed firm's response, the review team should recognize that it has not made an examination of the financial statements in question in accordance with generally accepted auditing standards and that it has not had the benefit of access to client records, discussions with the client, or specific knowledge of the client's business. Nevertheless, a disagreement on the resolution of the matter may persist in some circumstances and the reviewed firm should be aware that it may be requested by the state CPA society administering the review to refer unresolved matters to the AICPA Peer Review Board for a final determination.

### **Exit Conference**

.48 Prior to issuing its report and, if applicable, letter of comments, the review team must communicate its conclusions to senior members of the reviewed firm at an exit conference, which may also be attended by individuals with oversight responsibilities. The reviewed firm is entitled to be informed at the exit conference about any matters that may affect the review report and about all significant findings and recommendations that will be included in the letter of comments. Accordingly, except in rare circumstances which should be explained to the reviewed firm, the exit conference should be postponed if there is any uncertainty about the report to be issued or the matters to be included in the letter of comments. The exit conference is also the appropriate vehicle for providing suggestions to the firm that do not have an effect on the report or letter of comments.

## **Performing Off-Site Peer Reviews**

### **Objectives**

.49 The objective of an off-site peer review is to provide the reviewer with a reasonable basis for expressing limited assurance that the financial statements and related accountant's report on the review and compilation engagements submitted for review do not depart in a material respect from the requirements of professional standards. This objective is different from the objectives of an on-site peer review in recognition of the fact that off-site peer reviews are available only to firms that perform review or compilation engagements but perform no audits of historical or prospective financial statements. An accountant's review report expresses only limited assurance about the financial statements, and an accountant's compilation report states that the accountant expresses no opinion or other form of assurance on the historical or prospective financial statements. Such firms will only be required to have an off-site peer review unless they elect to have an on-site peer review. However, this does not relieve such firms from their obligation to have a system of quality control (see paragraph .03). Compliance with the positive enforcement program of a state board of accountancy does not constitute compliance with the AICPA practice-monitoring requirement.

## Basic Requirements

.50 The reviewed firm shall provide summarized information showing the number of its review or compilation clients and the nature of the service provided to those clients, classified into major industry categories. That information shall be provided for each owner of the firm who is responsible for the issuance of review or compilation reports. On the basis of that information, the reviewer or the state CPA society administering the review ordinarily shall select the types of engagements to be submitted for review, in accordance with the following guidelines:

- a. Select one review or compilation engagement involving a report on a complete set of financial statements as opposed to compilation reports on financial statements that omit substantially all of the disclosures required by generally accepted accounting principles or an other comprehensive basis of accounting, for each owner of the firm responsible for the issuance of such reports. However, at least two engagements must be selected for the firm.
- b. In selecting engagements for review, include both review and compilation engagements, if both levels of service are provided. Also, attempt to include clients operating in different industries and engagements involving prospective financial statements as well as those involving historical financial statements.
- c. In addition to the selection made in a above, select, where applicable, one set of financial statements that omit substantially all of the disclosures required by generally accepted accounting principles or an other comprehensive basis of accounting and the related accountant's compilation report. However, if the firm's accounting practice consists only of compilation reports on financial statements that omit substantially all required disclosures, the firm must submit the financial statements and related accountant's report for two such engagements.

The reviewed firm shall submit the appropriate financial statements and accountant's reports, masking client identity if it desires, along with specified background information and representations about each engagement. If the reviewed firm is a member of the private companies practice section, the reviewed firm shall also submit information concerning its compliance with the section's membership requirements. (See exhibit 1 [paragraph .78].)

.51 An off-site peer review consists only of reading the historical or prospective financial statements submitted by the reviewed firm and the accountant's review or compilation report thereon, together with certain background information and representations provided by the reviewed firm. The objective of the review of these engagements is to consider whether the financial statements appear to be in conformity with generally accepted accounting principles or, if applicable, with an other comprehensive basis of accounting, and whether the accountant's report appears to conform with professional standards. An off-site peer review does not include a review of the working papers prepared on the engagements submitted for review, tests of the firm's administrative or personnel files, interviews of selected firm personnel, or other procedures performed in an on-site peer review.

.52 Accordingly, an off-site peer review does not provide the reviewer with a basis for expressing any form of assurance on the firm's quality control policies and procedures for its accounting practice. The reviewer's report does

indicate, however, whether anything came to the reviewer's attention that caused him or her to believe that the review and compilation reports submitted for review did not conform with the requirements of professional standards.

**.53** A firm that has an off-site peer review must respond promptly to questions raised in the review, whether those questions are raised orally or in writing on a "Matter for Further Consideration" form. The reviewer will contact the firm, before issuing the review report, to resolve questions raised in the review.

**.54** Although an off-site peer review does not provide the reviewer with a basis for expressing any form of assurance on the firm's quality control policies and procedures for its accounting practice, it may provide the reviewer with a basis for expressing a conclusion that the firm did not have reasonable assurance of conforming with professional standards in the conduct of its accounting practice during the year under review (an adverse report). In those circumstances, the reviewed firm will be expected to take appropriate remedial, corrective actions with respect to its system of quality control and with respect to engagements with significant deficiencies. In addition, it will ordinarily be required to have another off-site peer review within twelve months.

**.55** The reviewer performing an off-site peer review must document the work performed using the programs and checklists issued by the AICPA Peer Review Board for that purpose. Failure to complete all relevant programs and checklists in a professional manner creates the presumption that the review has not been performed in conformity with these standards. Such a review cannot be accepted as meeting the requirements of the peer review program.

## **Reporting on Reviews**

### **General**

**.56** Within thirty days of the date of the exit conference or the date of completion of an off-site peer review, the team captain should furnish the reviewed firm with a written report and, where required, a letter of comments. A report on a review performed by a firm is to be issued on the letterhead of the firm performing the review. A report by a review team formed by an association of CPA firms is to be issued on the association's letterhead. All other reports are to be issued on the letterhead of the state CPA society administering the review. The report on an on-site peer review ordinarily should be dated as of the date of the exit conference. The report on an off-site peer review ordinarily should be dated as of the completion of the review procedures.

**.57** The team captain or, where provided by its plan of administration, an authorized association of CPA firms should notify the state CPA society administering the review that the review has been completed and should submit to that state CPA society a copy of the report and letter of comments, if any, and the working papers specified in the programs and checklists issued by the AICPA Peer Review Board.

**.58** The reviewed firm should submit a copy of the report, the letter of comments, if any, and its response to all matters discussed in the report or letter of comments to the state CPA society administering the review within thirty days of the date it received the report and letter.

**.59** The reviewed firm should not publicize the results of the review or distribute copies of the report to its personnel, its clients, or others until it has

been advised that the report has been accepted by the state CPA society administering the review as meeting the requirements of the AICPA peer review program. Neither the state CPA society nor the AICPA shall make the results of the review available to the public,<sup>8</sup> but may disclose on request the following information:

- a. The firm's name and address
- b. The firm's participation in the peer review program
- c. The date of, and the period covered by, the firm's last review
- d. If applicable, the termination of the firm from the program

### **Reports on On-Site Peer Reviews**

.60 The written report on an on-site peer review should indicate the scope of the review, including any limitations thereon; a description of the general characteristics of a system of quality control; an opinion on whether the system of quality control for the accounting and auditing practice of the reviewed firm met the objectives of quality control standards established by the AICPA and was being complied with during the year reviewed to provide the firm with reasonable assurance of conforming with professional standards; and a description of the reason(s) for any qualification of the opinion. If the reviewed firm is a member of the private companies practice section, the report should also indicate whether the firm complied with the membership requirements of the section in all material respects and a description of the reason(s) for any qualification.

.61 A team captain may issue an unqualified, qualified, or adverse report on the review. In deciding on the type of report to be issued, the team captain should be guided by the considerations discussed in appendix B [paragraph .80]. The standard form for an unqualified report is illustrated in appendix C [paragraph .81]. Illustrations of qualified and adverse reports are presented in appendix D [paragraph .82].

### **Reports on Off-Site Peer Reviews**

.62 The written report on an off-site peer review should describe the limited scope of the review and disclaim an opinion or any form of assurance about the firm's quality control policies and procedures for its accounting practice; indicate whether anything came to the reviewer's attention that caused the reviewer to believe that the review and/or compilation reports submitted for review did not conform with the requirements of professional standards in all material respects; and, if applicable, describe the general nature of significant departures from those standards. The report should also, where applicable, include the reviewer's conclusion that the firm did not have reasonable assurance of conforming with professional standards in the conduct of its accounting practice during the year under review. If the reviewed firm is a member of the private companies practice section, the report should also state whether anything came to the reviewer's attention that caused the reviewer to believe the firm was not complying with the section's membership requirements.

.63 In deciding on the type of report to be issued, the reviewer should be guided by the considerations in appendix G [paragraph .85]. The standard form for an unqualified report on an off-site peer review is illustrated in

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<sup>8</sup> If the firm is a member of the private companies practice section, the section's membership requirements provide that a copy of the report, letter of comments, if any, and the firm's response thereto be placed in the public files of the AICPA Division for CPA Firms. (See exhibit 1 [paragraph .78].)

appendix H [paragraph .86]. Illustrations of other types of reports are presented in appendix I [paragraph .87].

## Letters of Comments

.64 A letter of comments is required to be issued in connection with an on-site peer review when there are matters that resulted in a modification to the standard form of report or when there are matters that the review team believes resulted in conditions being created in which there was more than a remote possibility that the firm would not conform with professional standards on accounting and auditing engagements, or when a private companies practice section member firm has failed to comply with one or more of the section's membership requirements. Such a letter should provide reasonably detailed recommendations for remedial, corrective actions by the reviewed firm so that the state CPA society administering the review can evaluate whether the firm's response to the findings noted in the review is a positive one consistent with the objectives of the peer review program and whether the actions taken or planned by the firm appear appropriate in the circumstances.

.65 The letter of comments on an on-site peer review should be prepared in accordance with the guidance and illustrations in appendix E [paragraph .83]. An illustration of a response by a reviewed firm is included in appendix F [paragraph .84].

.66 A letter of comments is required to be issued in connection with an off-site peer review when there are matters that resulted in qualification(s) to the standard form of report or when the reviewer notes other departures from professional standards that are not deemed to be significant departures but that should be considered by the reviewed firm in evaluating the quality control policies and procedures over its accounting practice, or when a private companies practice section member firm has failed to comply with one or more of the section's membership requirements. Such a letter should provide reasonably detailed descriptions of the findings and recommendations so that the state CPA society administering the review can evaluate whether the actions taken or planned by the firm appear appropriate in the circumstances.

.67 In writing a letter of comments on an off-site peer review, consideration should be given to the guidance and illustrations in appendix J [paragraph .88]. An illustration of a response by a reviewed firm is included in appendix K [paragraph .89].

.68 When a letter of comments is issued along with a qualified or adverse report on an on-site or off-site peer review, the report on the review must make reference to the letter. No reference should be made to the letter of comments in an unqualified report.

## Acceptance of Reviews

.69 A committee or committees should be appointed by each participating state CPA society for the purpose of considering the results of reviews it administers that are undertaken to meet the requirements of the peer review program. The activities of such committees (hereafter, the committee) should be carried out in accordance with administrative procedures issued by the AICPA Peer Review Board.

.70 The committee's responsibility is to consider whether—

- a. The review has been performed in accordance with these standards and related guidance materials.

- b. The report, letter of comments, if any, and the response thereto are in accordance with these standards and related guidance material.
- c. It should require any remedial, corrective actions in addition to those described by the reviewed firm in its letter of response. Examples of such corrective actions are requiring certain individuals to obtain specified types and amounts of continuing professional education, requiring the firm to carry out a more comprehensive inspection program, requiring it to engage another CPA to perform preissuance reviews of financial statements and reports, or to attempt to strengthen its professional staff.
- d. It should monitor the corrective actions implemented by the reviewed firm. Examples of monitoring procedures are requiring the firm to submit information concerning continuing professional education obtained by firm personnel, inspection reports, or reports by another CPA engaged to perform preissuance reviews of financial statements and reports. Revisits by team captains and accelerated peer reviews are other examples of monitoring procedures.

.71 If no additional corrective actions are deemed necessary, the committee will accept the report and so notify the reviewed firm. If additional actions by the reviewed firm or if monitoring procedures are deemed necessary, the firm will be required to evidence its agreement in writing before the report is accepted.

.72 In the rare event of a disagreement between the committee and the review team or the reviewed firm that cannot be resolved by ordinary good-faith efforts, the committee may request that the matter be referred to the AICPA Peer Review Board for final resolution. In these circumstances, the AICPA Peer Review Board may consult with representatives of AICPA technical or ethical committees or with appropriate AICPA staff.

.73 In reaching its conclusions, the committee is authorized to make whatever inquiries or initiate whatever actions it considers necessary in the circumstances, including requesting revision of the report, the letter of comments, or the reviewed firm's response, with due regard for the fact that the peer review program is intended to be positive and remedial in nature, and is based on mutual trust and cooperation. Accordingly, in deciding on the need for and nature of any additional corrective actions or monitoring procedures, the committee should consider the nature, significance, pattern, and pervasiveness of engagement deficiencies. It should evaluate whether the recommendations of the review team appear to address those deficiencies adequately and whether the reviewed firm's responses to those recommendations appear comprehensive, genuine, and feasible. In a subsequent review, its conclusions should be significantly influenced by a finding that the reviewed firm did not adequately implement significant corrective actions it had represented it would take and by the committee's assessment of the reason for such a failure. If such a failure continues despite requirements for corrective actions and appropriate monitoring, the committee should consider whether requirements for remedial, corrective actions are adequate responses to the situation.

.74 If a reviewed firm refuses to cooperate, fails to correct material deficiencies, or is found to be so seriously deficient in its performance that education and remedial, corrective actions are not adequate, the AICPA Peer Review Board may take actions, pursuant to due process procedures that it

has established, leading to the termination of the firm's enrollment or participation in the AICPA peer review program.<sup>9</sup>

.75 If a decision is made to terminate a firm's enrollment in the AICPA peer review program, the firm will have the right to appeal to the AICPA Joint Trial Board for a review of the findings. The trial board will have the authority to confirm or to reduce the severity of the findings, but it will not have the authority to increase their severity. The fact that a firm's enrollment in the AICPA peer review program has been terminated shall be reported in an AICPA membership periodical.

.76 If a decision is made to terminate the participation of a PCPS member firm in the AICPA peer review program, that fact shall be reported to the private companies practice section for action leading to the termination of the firm's membership in the private companies practice section. Under the organizational structure and functions document of the section, the firm can appeal to the Private Companies Practice Executive Committee for a review of the findings.

## **Qualifications of Committee Members**

.77 Each member of a committee charged with the responsibility for acceptance of reviews must be currently active in public practice at a supervisory level in the accounting or auditing function of a firm enrolled in an approved practice-monitoring program as an owner of the firm or as a manager or person with equivalent supervisory responsibilities. A majority of the members must also possess the qualifications required of on-site peer review team captains. A member may not participate in any discussion or have any vote with respect to a reviewed firm when the member lacks independence or has a conflict of interest with the firm.

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<sup>9</sup> Appendix A to the organizational structure and functions document of the private companies practice section (see *PCPS Reference Manual*, section 1000) contains provisions for automatically dropping or terminating the membership of firms in the private companies practice section that fail to meet certain requirements related to their peer review.



**Exhibit 1**

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**Additional Requirements for Members of the Private Companies Practice Section\***

1. Effective April 3, 1995, a member of the private companies practice section of the AICPA Division for CPA Firms shall comply with the section's requirement for mandatory peer review by—

- a. Having a review administered under the AICPA peer review program or, if it is or becomes a member of the SEC practice section of the AICPA Division for CPA Firms, a review administered by that section.
- b. Complying with all of the standards and requirements of the applicable practice-monitoring program and with any additional requirements as may be established or modified from time to time by the Private Companies Practice Executive Committee.

2. The Private Companies Practice Executive Committee has established the following additional *membership* requirements.

- a. Ensure that the firm complies with rule 505 [ET section 505.01] of the AICPA Code of Professional Conduct and related implementing resolutions of Council, that it can legally engage in the practice of public accounting, and that each owner of the firm eligible for AICPA membership is a member of the AICPA.
- b. Adhere to the quality control standards established by the AICPA.
- c. Ensure that all professionals in the firm residing in the United States, including CPAs and non-CPAs, take part in qualifying continuing professional education as follows:
  - (i) Participate in at least 120 hours every three years, but not less than 20 hours every year, or
  - (ii) Comply with mandatory continuing professional education requirements for state licensing or for state CPA society membership, provided such state or society requirements require an average of 40 hours per year of continuing professional education for each reporting period, and provided each professional in the firm participates in at least 20 hours every year.
- d. Pay dues as established by the executive committee, and comply with the rules and regulations of the section as established from time to time by the executive committee and with the decisions of the executive committee in respect of matters within its competence; cooperate with the committee responsible for administering the firm's peer review in connection with that committee's duties, including disciplinary matters; and comply with any sanction which may be imposed by the executive committee.
- e. File with the section for each fiscal year certain nonfinancial information about the firm within 90 days of the end of such fiscal year, to be open to public inspection.

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\* This exhibit includes summarized information from Section 1000 of the *PCPS Reference Manual* entitled "Organizational Structure and Functions of the Private Companies Practice Section."

3. The Private Companies Practice Executive Committee has also established the following additional *peer review* requirements:

- a. Each member of a review team performing a peer review of a firm that is a section member shall be associated with a firm that is a section member. Also, the firm with which the team captain is associated shall have received an unqualified report on its most recent peer review and that report shall have covered the firm's compliance with the section's membership requirements.
- b. The report, the letter of comments, and the reviewed firm's response shall be placed in the public files of the section at AICPA headquarters. If additional actions are deemed necessary by the committee responsible for administering the firm's review, a memorandum indicating that they have been accepted with the understanding that the firm will agree to take certain actions shall also be placed in the public file. The letter setting forth those actions and the firm's agreement to undertake them shall be placed in the public file upon receipt.
- c. The peer review shall include appropriate tests of the firm's compliance with the membership requirements of the section and the report shall include an opinion on whether the reviewed firm complied with the membership requirements of the section in all material respects and, if not, a description of the reasons for the qualification.

## **Appendix A**

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### **Independence Requirements**

#### **Reciprocal Reviews**

1. Reciprocal reviews are not permitted. This means that a firm may not perform a review of the firm that performed its most recent quality review or peer review. It also means that no professional may serve on a review team carrying out a review of a firm whose professional personnel participated in the most recent review of that professional's firm.

#### **Relationships With Clients of the Reviewed Firm**

2. Review team members and, in the case of a review performed by a firm, the reviewing firm and its personnel are not precluded from owning securities in or having family or other relationships with clients of the reviewed firm. However, a review team member who owns securities of a reviewed firm's client shall not review the engagement of that client, since that individual's independence would be considered to be impaired. In addition, the effect on independence of family and other relationships and the possible resulting loss of the appearance of independence must be considered when assigning team members to engagements.

#### **Relationships With the Reviewed Firm**

3. Reviewing firms should consider any family or other relationships between the senior managements at organizational and functional levels of the reviewing firm and the firm to be reviewed and should assess the possibility of an impairment of independence.

4. If the fees for correspondent work, whether paid by the referring firm or by the client, involving the reviewed firm and the reviewing firm or the firm of any member of the review team are material to any of those firms, independence for the purposes of this program is impaired.

5. If continuing arrangements exist between the reviewed firm and the reviewing firm or the firm of any member of the review team whereby fees, office facilities, or professional staff are shared, independence for the purposes of this program is impaired. Similarly, independence would be considered to be impaired by sharing arrangements involving, for example, frequent continuing education programs, extensive consultation, preissuance reviews of financial statements and reports, and audit and accounting manuals. In such circumstances, the firms involved are sharing materials and services that are an integral part of their quality control systems. However, the impairment would be removed if an independent review was made of the shared materials (such as continuing education programs or an audit and accounting manual) before the peer review commenced and that independent review was accepted by the AICPA Peer Review Board or the relevant state CPA society (or the SEC Practice Section Peer Review Committee of the AICPA Division for CPA Firms) before that date. (Firms that share materials and services are advised to consult with the AICPA Peer Review Division if an independent review of such shared materials and services appears necessary.) Also, independence for the purposes of this program is not impaired by the performance of a review of a firm's quality control document, of a preliminary quality control procedures review or consulting review, or an inspection.

## Appendix B

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### Considerations Governing the Type of Report Issued on an On-Site Peer Review

#### Limitation on Scope of Review

1. A qualified report should be issued when the scope of the review is limited by conditions that preclude the application of one or more review procedures considered necessary in the circumstances and the review team cannot accomplish the objectives of those procedures through alternate procedures. For example, as indicated in the Standards, a review team may be able to apply appropriate alternate procedures when one or more engagements have been excluded from the scope of the review for legitimate reasons but ordinarily would be unable to apply alternate procedures when a significant portion of the firm's accounting and auditing practice during the year reviewed had been divested before the review began. A review team captain who is considering qualifying the review report for a scope limitation should consult with the state CPA society administering the review.

#### The Nature and Significance of Engagement Deficiencies

2. The overriding objective of a system of quality control is to provide the firm with reasonable assurance of conforming with professional standards in the conduct of its accounting and auditing practice. When a review team encounters significant failures to reach appropriate conclusions, particularly those requiring the application of SAS No. 46, *Consideration of Omitted Procedures After the Report Date* [AU section 390], and SAS No. 1, section 561 entitled *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* [AU section 561], the team is faced with a clear indication that, in those engagements, the firm failed to conform with professional standards. The review team's first task in such circumstances is to try to determine why the failure occurred. The cause of the failure might be systems-related and might affect the type of report issued when, for example—

- a. The failure related to a specialized industry practice and the firm had no experience in that industry and made no attempt to acquire training in the industry or to obtain appropriate consultation and assistance.
- b. The failure related to a matter covered by a recent professional pronouncement and the firm had failed to identify through professional development programs or appropriate supervision the relevance of that pronouncement to its practice.
- c. The failure should have been detected if the firm's quality control policies and procedures had been followed.
- d. The failure should have been detected by the application of quality control policies and procedures commonly found in firms similar in size or nature of practice. That judgment can often be made by the reviewer based on personal experience or knowledge; in some cases, the reviewer will wish to consult with the state CPA society administering the review before reaching such a conclusion.

3. The failure to conform with professional standards on an engagement may be the result of an isolated human error and, therefore, does not necessarily mean that the review report should be qualified or adverse. However, when the reviewer believes that the probable cause (for example, a failure to provide

or follow appropriate policies for supervision of the work of assistants) of a significant failure to conform with professional standards on one engagement also exists in other engagements, the reviewer needs to consider carefully the need for a qualified or adverse report.

### **The Pattern and Pervasiveness of Engagement Deficiencies**

4. The review team must consider the pattern and pervasiveness of engagement deficiencies and their implications for compliance with the firm's system of quality control as a whole, in addition to their nature and significance in the specific circumstances in which they were observed. As in the preceding section, the review team's first task is to try to determine why the deficiencies occurred. In some cases, the design of the firm's system of quality control may be deficient as, for example, when it does not provide for timely involvement in the planning process by an owner of the firm. In other cases, there may be a pattern of noncompliance with a quality control policy or procedure as, for example, when firm policy requires the completion of a financial statement disclosure checklist but such checklists often were used only as a reference and not filled out. That, of course, makes effective review by the owner of the firm more difficult and increases the possibility that the firm might not conform with professional standards in a significant respect, which means that the reviewer must consider carefully the need for a qualified or adverse report. On the other hand, the types of deficiencies noted may be individually different, not individually significant, and not directly traceable to the design of or compliance with a particular quality control policy or procedure. This may lead the reviewer to the conclusion that the deficiencies were isolated cases of human error that should not result in a qualified or adverse report.

### **Design Deficiencies**

5. There may be circumstances when the reviewer finds few deficiencies in the work performed by the firm and yet may conclude that the design of the firm's quality control system needs to be improved. For example, a firm that is growing rapidly and adding personnel and clients may not be giving appropriate attention to necessary policies and procedures in areas such as hiring, assigning personnel to engagements, advancement, and client acceptance and continuance. A reviewer might conclude that these conditions could create a situation in which the firm would not have reasonable assurance of conforming with professional standards in one or more important respects. However, in the absence of deficiencies in the engagements reviewed, the reviewer would ordinarily conclude that the matter should be dealt with in the letter of comments.

### **Noncompliance With Private Companies Practice Section Membership Requirements**

6. If a firm is a member of the private companies practice section, the review team is required to evaluate whether the firm complied in all material respects with each of the membership requirements of the section. While adherence to all membership requirements in every situation may not have been possible, a high degree of compliance is expected. In evaluating the significance of noncompliance with a membership requirement, the review team should recognize that those requirements directly related to the quality of performance on accounting and auditing engagements are more critical.

### **Forming Conclusions**

7. In order to give appropriate consideration to the evidence obtained and to form appropriate conclusions, the review team must understand the ele-

ments of quality control and exercise professional judgment. The exercise of professional judgment is essential because the significance of the evidence obtained cannot be evaluated primarily on a quantitative basis.

**Appendix C**

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**Standard Form for an Unqualified Report on an On-Site Peer Review****Firm in the AICPA Peer Review Program\***

*[State CPA society letterhead for a "CART Review"; firm letterhead for a "Firm-on-Firm Review"; association letterhead for an "Association Review"]*

August 31, 19XX

To the Owners

Able, Baker &amp; Co.

*or*

To John B. Able, CPA

We have reviewed the system of quality control for the accounting and auditing practice of *[Name of Firm]* (the firm) in effect for the year ended June 30, 19XX. Our review was conducted in conformity with standards established by the Peer Review Board of the American Institute of Certified Public Accountants (AICPA). We tested compliance with the firm's quality control policies and procedures to the extent we considered appropriate. These tests included a review of selected accounting and auditing engagements.

In performing our review, we have given consideration to the quality control standards issued by the AICPA. Those standards indicate that a firm's system of quality control should be appropriately comprehensive and suitably designed in relation to the firm's size, organizational structure, operating policies, and the nature of its practice. They state that variance in individual performance can affect the degree of compliance with a firm's quality control system and, therefore, recognize that there may not be adherence to all policies and procedures in every case.

In our opinion, the system of quality control for the accounting and auditing practice of *[Name of Firm]* in effect for the year ended June 30, 19XX, met the objectives of quality control standards established by the AICPA and was being complied with during the year then ended to provide the firm with reasonable assurance of conforming with professional standards in the conduct of that practice.

John Brown, Team Captain

*[or Name of Reviewing Firm]*

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\* No copy of this report or any other document related to the review will be placed in a public file.

**Firm in the Private Companies Practice Section\***

*[State CPA society letterhead for a "CART Review"; firm letterhead for a "Firm-on-Firm Review"; association letterhead for an "Association Review"]*

August 31, 19XX

To the Owners

Smith, Jones & Co.

or

To John R. Smith, CPA

We have reviewed the system of quality control for the accounting and auditing practice of *[Name of Firm]* (the firm) in effect for the year ended June 30, 19XX. Our review was conducted in conformity with standards established by the Peer Review Board of the American Institute of Certified Public Accountants (AICPA). We tested compliance with the firm's quality control policies and procedures to the extent we considered appropriate. These tests included a review of selected accounting and auditing engagements.

In performing our review, we have given consideration to the quality control standards issued by the AICPA. Those standards indicate that a firm's system of quality control should be appropriately comprehensive and suitably designed in relation to the firm's size, organizational structure, operating policies, and the nature of its practice. They state that variance in individual performance can affect the degree of compliance with a firm's quality control system and, therefore, recognize that there may not be adherence to all policies and procedures in every case.

In our opinion, the system of quality control for the accounting and auditing practice of *[Name of Firm]* in effect for the year ended June 30, 19XX, met the objectives of quality control standards established by the AICPA and was being complied with during the year then ended to provide the firm with reasonable assurance of conforming with professional standards in the conduct of that practice.

*[Name of Firm]* is a member of the private companies practice section of the AICPA Division for CPA Firms (the section) and has agreed to comply with the membership requirements of the section. In connection with our review, we tested the firm's compliance with those requirements to the extent we considered appropriate. In our opinion, the firm was in conformity with the membership requirements of the section during the year ended June 30, 19XX, in all material respects.

John Brown, Team Captain

*[or Name of Reviewing Firm]*

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\* Pursuant to the membership requirements of the private companies practice section, a copy of this report, the letter of comments, if any, and the firm's response thereto will be placed in the public files of the AICPA Division for CPA Firms, along with the letter from the state CPA society accepting those documents.



**Appendix D**

.82

**Illustrations of Qualified and Adverse Reports on an On-Site Peer Review****Report Qualified for Design Deficiency***[Separate paragraph after the standard first two paragraphs]*

As discussed in our letter of comments under this date, our review disclosed that the firm's quality control policies and procedures for supervision regarding audit planning were not appropriately designed to provide the firm with reasonable assurance of conforming with professional standards.

*[Opinion paragraph]*

In our opinion, except for the deficiency described in the preceding paragraph, the system of quality control....

**Report Qualified for Noncompliance With Quality Control Policies and Procedures***[Separate paragraph after the standard first two paragraphs]*

As discussed in our letter of comments under this date, our review disclosed that the firm's quality control policies and procedures for supervision regarding completion of financial statement reporting and disclosure checklists were not followed in a manner to provide the firm with reasonable assurance of conforming with professional standards.

*[Opinion paragraph]*

In our opinion, except for the deficiency described in the preceding paragraph, the system of quality control....

**Adverse Report***[Separate paragraph after the standard first two paragraphs]*

As discussed in our letter of comments under this date, our review disclosed several failures to adhere to professional standards in reporting on material departures from generally accepted accounting principles, in applying other generally accepted auditing standards, and in complying with the standards for accounting and review services. In that connection, our review disclosed that the firm's quality control policies and procedures were not appropriately designed because they do not require the preparation of a written audit program, which is required by generally accepted auditing standards. In addition, our review disclosed failures to complete financial statement reporting and disclosure checklists required by firm policy and failures to review engagement working papers in the manner required by firm policy.

*[Opinion paragraph]*

In our opinion, because of the significance of the matters discussed in the preceding paragraph, the system of quality control for the accounting and auditing practice of *[Name of Firm]* in effect for the year ended June 30, 19XX, did not meet the objectives of quality control standards established by the AICPA (, was not being complied with during the year then ended *[include*

when there are compliance as well as design deficiencies) and did not provide the firm with reasonable assurance of conforming with professional standards in the conduct of that practice.

**Report Qualified for Noncompliance With the Private Companies Practice Section Membership Requirements\***

*[Fourth paragraph after the first three paragraphs of the standard report on a firm in the private companies practice section]*

*[Name of Firm]* is a member of the private companies practice section of the AICPA Division for CPA Firms (the section) and has agreed to comply with the membership requirements of the section. In connection with our review, we tested the firm's compliance with those requirements to the extent we considered appropriate. In our opinion, except for the failure of a significant number of professionals to participate in the required number of hours of qualifying continuing professional education, the firm was in conformity with the membership requirements of the section during the year ended June 30, 19XX, in all material respects, as discussed in our letter of comments under this date.

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\* If the opinion expressed on the quality control system is adverse, the opinion expressed concerning the firm's compliance with the membership requirements of the private companies practice section should also be adverse. This can be accomplished by stating in the last sentence of the fourth paragraph that "the firm was not in conformity with the membership requirements of the section in all material respects because it did not comply with the AICPA quality control standards for the year ended June 30, 19XX."

## Appendix E

.83

### Guidelines for and Illustration of a Letter of Comments on an On-Site Peer Review

#### Guidelines

1. The objectives of the letter of comments on an on-site peer review are set forth in the Standards. Such letters are expected to be issued on most on-site reviews.

2. The letter should be addressed, dated, and signed in the same manner as the report on the on-site peer review, and should include—

- a. A reference to the report on the review, indicating, where applicable, that the report was qualified or adverse.
- b. A description of the purpose of the on-site peer review.
- c. A statement that the review was performed in accordance with standards established by the Peer Review Board of the AICPA.
- d. A description of the limitations of a system of quality control.
- e. The findings on the review and related recommendations. (This section should be separated between those findings, if any, that resulted in a qualified or adverse report and those that did not. In addition, the letter should identify, where applicable, any comments that were also made in the letter of comments issued on the firm's previous peer review.)
- f. A statement that the matters discussed in the letter were considered in determining the opinion on the system of quality control.

3. In addition to matters that resulted in a qualified or adverse report, which must always be included in the letter, the letter of comments should include, according to the Standards, "matters that the review team believes resulted in conditions being created in which there was more than a remote possibility that the firm would not conform with professional standards on accounting and auditing engagements, or when a private companies practice section member firm has failed to comply with one or more of the section's membership requirements." The letter should include comments on such matters even if they did not result in deficiencies on the engagements reviewed. When engagement deficiencies, particularly instances of nonconformity with professional standards, were attributable to deficiencies in the design of the firm's system of quality control or noncompliance with significant firm policies and procedures that are included in the letter, that fact should be noted in the comment.

4. Although isolated instances of noncompliance with the firm's quality control policies and procedures ordinarily would not be included in a letter of comments, their nature, importance, causes (if determinable), and implications for the firm's quality control system as a whole should be evaluated in conjunction with the review team's other findings before making a final determination.

**Illustration of a Letter of Comments**

*[State CPA society letterhead for a "CART Review"; firm letterhead for a "Firm-on-Firm Review"; association letterhead for an "Association Review"]*

August 31, 19XX

To the Owners  
Able, Baker & Co.

or

To John B. Able, CPA

We have reviewed the system of quality control for the accounting and auditing practice of *[Name of Firm]* (the firm) in effect for the year ended June 30, 19XX, and have issued our report thereon dated August 31, 19XX (, which was qualified as described therein).<sup>\*</sup> This letter should be read in conjunction with that report.

Our review was for the purpose of reporting upon the firm's system of quality control and its compliance with that system and with the membership requirements of the private companies practice section.<sup>†</sup> Our review was conducted in conformity with standards established by the Peer Review Board of the American Institute of Certified Public Accountants; however, our review would not necessarily disclose all weaknesses in the system or all instances of noncompliance with it [and with the membership requirements of the section]<sup>†</sup> because our review was based on selective tests.

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of quality control. In the performance of most control procedures, departures can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors. Projection of any evaluation of a system of quality control to future periods is subject to the risk that the procedure may become inadequate because of changes in conditions or that the degree of compliance with the procedure may deteriorate. As a result of our review, we have the following comments:

***Matters That Resulted in a Qualified Report<sup>††</sup>*****Supervision**

***Finding***—The firm's quality control policies and procedures do not require owner involvement in the planning stage of audit engagements. Generally accepted auditing standards permit the auditor with final responsibility for the engagement to delegate some of this work to assistants, but emphasize the importance of proper planning to the conduct of the engagement. We found one engagement in which, as a result of a lack of involvement, including timely supervision, by the engagement owner in planning the audit, the work performed on receivables and inventory did not appear to support the firm's opinion on the financial statements. (As a result of this finding, the firm performed the necessary additional procedures to provide a satisfactory basis for its opinion.)

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<sup>\*</sup> This phrase should be used only if a qualified or adverse report is being issued, and it should be tailored to fit the circumstances.

<sup>†</sup> These phrases should be used only if the reviewed firm is a member of the private companies practice section.

<sup>††</sup> This caption should be used only if a qualified or adverse report is being issued, and it should be tailored to fit the circumstances.

**Recommendation**—The firm's quality control policies and procedures should be revised to provide, at a minimum, for timely audit owner review of the preliminary audit plan and the audit program.

***Matters That Did Not Result in a Qualified Report\****

**Supervision**

**Finding**—The firm's quality control policies and procedures require the completion of a financial reporting and disclosure checklist on each financial statement engagement. Our review disclosed the firm had not complied with this policy on all of the engagements reviewed. In each case where a checklist was not completed, we also found certain financial statement disclosures were missing or incomplete. None of the missing or incomplete disclosures represented significant departures from professional standards.

**Recommendation**—The firm should hold training courses on proper completion of its financial reporting and disclosure checklist and reemphasize its policy requiring completion of that checklist.

**Consultation**

**Finding**—Our review disclosed that the firm's reference library contains outdated editions of industry audit and accounting guides for industries in which some of the firm's clients operate. As a result, we found a few instances where financial statement formats departed, although not in material respects, from current practice.

**Recommendation**—The firm should assign the responsibility for ensuring that the library is comprehensive and up to date to one individual. That individual should monitor new publications, determine which should be obtained, and periodically advise professional personnel of additions to the library.

The foregoing matters were considered in determining our opinion set forth in our report dated August 31, 19XX, and this letter does not change that report.

*[Same signature as on the report on the on-site peer review]*

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\* This caption should be used only if a qualified or adverse report is being issued, and it should be tailored to fit the circumstances.

**Appendix F**

.84

**Illustration of a Response by a Reviewed Firm to a Letter of Comments on an On-Site Peer Review**

The purpose of a letter of response is to describe the actions the firm has taken or will take to prevent a recurrence of each matter discussed in the letter of comments. If the reviewed firm disagrees with one or more of the findings or recommendations in the letter of comments, its response should describe the reasons for such disagreement. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see the section of these Standards on "Acceptance of Reviews" [paragraphs .69 through .76]). If the firm has received a qualified or adverse report, the firm's responses should be separated between those findings that resulted in a qualified or adverse report and those that did not.

\* \* \* \*

**Sample Letter of Response**

September 15, 19XX

*[Addressed to the state CPA society administering the review]*

Ladies and Gentlemen:

This letter represents our response to the letter of comments issued in connection with our firm's on-site peer review for the year ended June 30, 19XX. The matters discussed herein were brought to the attention of all professional personnel at a training session held on September 10, 19XX. In addition, the matters discussed in this letter will be monitored to ensure they are effectively implemented as a part of our quality control system.

***Matters That Resulted in a Qualified Report\****

***Owner Involvement in Audit Planning***—The firm modified its quality control policies and procedures to require an owner to be involved in the planning stage of all audit engagements. In addition, we identified review engagements that are sufficiently large or complex to warrant owner involvement in the planning stage. The revised policies and procedures require the engagement owner to document his or her timely involvement in the planning process in the planning section of the written work program. The importance of proper planning, including timely owner involvement, to quality work was emphasized in the training session referred to above.

***Matters That Did Not Result in a Qualified Report\****

***Financial Reporting and Disclosure Checklists***—All professional personnel were reminded of the importance of complying with the firm's policy requiring completion of its financial reporting and disclosure checklist at the training session held on September 10, 19XX. In addition, the firm's engagement

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\* This caption should be used only if a qualified or adverse report is being issued, and it should be tailored to fit the circumstances.

review questionnaire is being revised to require the engagement owner to document his or her review of the completed checklist. (The engagement review questionnaire is a brief form completed by the engagement owner and manager at the conclusion of an audit to document their completion of their assigned responsibilities.)

Responsibility for Reference Library—The responsibility for keeping the firm's reference library comprehensive and up to date and for advising professional personnel of additions to the library has been assigned to an experienced audit manager. Current editions of industry audit and accounting guides have been ordered.

\* \* \* \*

We believe these actions are responsive to the findings of the review.

Sincerely,

*[Name of Firm]*

**Appendix G**

.85

**Considerations Governing the Type of Report Issued on an Off-Site Peer Review****Circumstances Calling for a Qualified Report**

1. The objective of an off-site peer review is to provide the reviewer with a reasonable basis for expressing limited assurance that the financial statements and related accountant's report on review and compilation engagements submitted for review do not depart in a material respect from the requirements of professional standards. Accordingly, when the review discloses significant departures from professional standards in the engagements reviewed, those departures should be clearly described in the review report as exceptions to the limited assurance expressed in the report. In this context, a significant departure from professional standards involves—

- a. A departure from the measurement or disclosure requirements of generally accepted accounting principles or, where applicable, an other comprehensive basis of accounting, that can have a significant effect on the user's understanding of the financial information presented and that is not described in the accountant's report. Examples might include a failure to provide an allowance for doubtful accounts when it is probable that a material amount of accounts receivable is uncollectible; the use of an inappropriate method of revenue recognition; a failure to capitalize financing leases or to make important disclosures about significant leases; a failure to disclose significant related-party transactions; or a failure to disclose key assumptions in a financial forecast.
- b. The issuance of a review report that is misleading in the circumstances. Examples might include a review report on financial statements that omit substantially all of the disclosures required by generally accepted accounting principles; or a review report that refers to conformity with generally accepted accounting principles when the financial statements have been prepared on an other comprehensive basis of accounting.
- c. The issuance of a compilation report that is misleading in the circumstances. Examples might include a report on compiled financial statements that omit substantially all disclosures required by generally accepted accounting principles that does not clearly indicate the omission in the report; or a compilation report on financial statements prepared on an other comprehensive basis of accounting that does not disclose the basis of accounting in the report or in a note to the financial statements.

2. The objective of an off-site peer review of a member of the private companies practice section is also to provide the reviewer with a reasonable basis for expressing limited assurance that the firm has complied with the membership requirements of the section in all material respects.

**Circumstances Calling for an Adverse Report**

3. As indicated in these Standards, an off-site peer review does not provide the reviewer with a basis for expressing any form of assurance on the reviewed firm's quality control policies and procedures, but it may provide the



reviewer with a basis for expressing a conclusion that the firm did not have reasonable assurance of conforming with professional standards in the conduct of its accounting practice during the year under review. Deciding whether the findings of an off-site peer review support the conclusion requires the careful exercise of professional judgment. In reaching a decision, the reviewer would ordinarily consider the significance of the departures from professional standards, as described above, that were disclosed by the review and the pervasiveness of such departures. In that connection, the reviewer needs to give appropriate weight to the fact that the report on an off-site review only addresses conformity with professional standards and not the system of quality control.

#### **Other Departures That May Require Disclosure**

4. The reviewer may note other departures from professional standards that are not deemed to be significant departures but that should be considered by the reviewed firm in evaluating the quality control policies and procedures over its accounting practice. The reviewer should describe these findings in the letter of comments (see appendix J [paragraph .88]).

**Appendix H**

.86

**Standard Form for an Unqualified Report on an Off-Site Peer Review****Firm in the AICPA Peer Review Program\***

*[State CPA society letterhead for a "CART Review"; firm letterhead for a "Firm-on-Firm Review"; association letterhead for an "Association Review"]*

August 31, 19XX

To the Owners

Able, Baker &amp; Co.

or

To John B. Able, CPA

We (I) have performed an off-site peer review with respect to the accounting practice of *[Name of Firm]* for the year ended June 30, 19XX, in accordance with standards established by the Peer Review Board of the American Institute of Certified Public Accountants. *[Name of Firm]* has represented to us (me) that it performed no audits *[(or compilations) (or reviews)]*<sup>†</sup> of historical or prospective financial statements during the year ended June 30, 19XX.

An off-site peer review consists only of reading selected financial statements and the accountant's compilation or review report thereon, together with certain information and representations provided by the firm, for the purpose of considering whether the financial statements appear to be in conformity with generally accepted accounting principles or, if applicable, with an other comprehensive basis of accounting, and whether the accountant's report appears to conform with the requirements of professional standards. An off-site peer review does not provide the reviewer with a basis for expressing any assurance as to the firm's quality control policies and procedures for its accounting practice, and we (I) express no opinion or any form of assurance on them.

In connection with our (my) off-site peer review, nothing came to our (my) attention that caused us (me) to believe that the *[(compilation and review) (compilation) (review)]*<sup>†</sup> reports submitted for review by *[Name of Firm]* and issued in the conduct of its accounting practice during the year ended June 30, 19XX, did not conform with the requirements of professional standards in all material respects.

John Brown, Reviewer<sup>††</sup>*[or Name of Reviewing Firm]*

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\* No copy of this report or any other documents related to this review will be placed in a public file.

<sup>†</sup> Tailor as appropriate.

<sup>††</sup> The description *Reviewer*, not *Team Captain*, should be used in reports on off-site peer reviews.

**Firm in the Private Companies Practice Section\***

*[State CPA society letterhead for a "CART Review"; firm letterhead for a "Firm-on-Firm Review"; association letterhead for an "Association Review"]*

August 31, 19XX

To the Owners

Able, Baker & Co.

or

To John B. Able, CPA

We (I) have performed an off-site peer review with respect to the accounting practice of *[Name of Firm]* for the year ended June 30, 19XX, in accordance with standards established by the Peer Review Board of the American Institute of Certified Public Accountants. *[Name of Firm]* has represented to us (me) that it performed no audits *[(or compilations) (or reviews)]*<sup>†</sup> of historical or prospective financial statements during the year ended June 30, 19XX.

An off-site peer review consists only of reading selected financial statements and the accountant's compilation or review report thereon, together with certain information and representations provided by the firm, for the purpose of considering whether the financial statements appear to be in conformity with generally accepted accounting principles or, if applicable, with an other comprehensive basis of accounting, and whether the accountant's report appears to conform with the requirements of professional standards. An off-site peer review does not provide the reviewer with a basis for expressing any assurance as to the firm's quality control policies and procedures for its accounting practice, and we (I) express no opinion or any form of assurance on them.

In connection with our (my) off-site peer review, nothing came to our (my) attention that caused us (me) to believe that the *[(compilation and review) (compilation) (review)]*<sup>†</sup> reports submitted for review by *[Name of Firm]* and issued in the conduct of its accounting practice during the year ended June 30, 19XX, did not conform with the requirements of professional standards in all material respects.

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\* Pursuant to the membership requirements of the private companies practice section, a copy of this report, the letter of comments, if any, and the firm's response thereto will be placed in the public files of the AICPA Division for CPA Firms, along with the letter from the state CPA society accepting those documents.

<sup>†</sup> Tailor as appropriate.

*[Name of Firm]* is a member of the private companies practice section of the AICPA Division for CPA Firms (the section) and has agreed to comply with the membership requirements of the section. In connection with our review, we tested the firm's compliance with those requirements to the extent we considered appropriate. Nothing came to our (my) attention that caused us (me) to believe that the firm did not conform with the membership requirements of the section during the year ended June 30, 19XX, in all material respects.

John Brown, Reviewer\*  
*[or Name of Reviewing Firm]*

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\* The description *Reviewer*, not *Team Captain*, should be used in reports on off-site peer reviews.

**Appendix I****.87****Illustrations of Other Types of Reports on an Off-Site Peer Review**

*[See appendix H [paragraph .86] for information about applicable letterhead and about addressing and signing the report]*

**Qualified Report for Significant Departures from Professional Standards**

*[Separate paragraph, after the standard first two paragraphs, describing the significant matters that resulted in a qualified report]*

As discussed in our (my) letter of comments under this date, the firm's review report on the financial statements of one of the engagements submitted for review did not disclose the failure to capitalize a financing lease, as required by generally accepted accounting principles. Also, significant financial statement disclosure deficiencies concerning related-party transactions were noted in several of the engagements reviewed.

*[Concluding paragraph]*

In connection with our (my) off-site peer review, with the exception of the matter(s) described in the preceding paragraph, nothing came to our (my) attention that caused us (me) to believe that the compilation and review reports submitted for review by *[Name of Firm]* and issued in the conduct of its accounting practice during the year ended June 30, 19XX, did not conform with the requirements of professional standards in all material respects.

**Adverse Report on an Off-Site Peer Review**

*[Separate paragraph, after the standard first two paragraphs, describing the significant matters that resulted in an adverse report]*

However, as discussed in our (my) letter of comments under this date, our (my) review disclosed several failures to adhere to professional standards in reporting on material departures from generally accepted accounting principles and in complying with standards for accounting and review services. Specifically, the firm did not disclose in certain compilation and review reports failures to comply with generally accepted accounting principles in accounting for leases, in accounting for revenue from construction contracts, and in disclosures made in the financial statements or the notes thereto concerning various matters important to an understanding of those statements.

*[Adverse concluding paragraph]*

Because of the significance of the matters described in the preceding paragraph, we (I) believe *[Name of Firm]* did not have reasonable assurance of conforming with professional standards in the conduct of its accounting practice during the year ended June 30, 19XX.

**Qualified Report for Noncompliance With the Private Companies Practice Section Membership Requirements\***

*[Fourth paragraph, after the standard first three paragraphs, describing the noncompliance with the applicable membership requirement]*

*[Name of Firm]* is a member of the private companies practice section of the AICPA Division for CPA Firms (the section) and has agreed to comply with the membership requirements of the section. In connection with our review, we tested the firm's compliance with those requirements to the extent we considered appropriate. Except for the failure of a significant number of professionals to participate in the required number of hours of qualifying continuing professional education, nothing came to our (my) attention that caused us (me) to believe that the firm did not conform with the membership requirements of the section during the year ended June 30, 19XX, in all material respects.

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\* If the report on the accounting practice is adverse, the report on the firm's compliance with the membership requirements of the private companies practice section should also be adverse. This can be accomplished by stating in the last sentence of the fifth paragraph that "We (I) also believe the firm was not in conformity with the membership requirements of the section in all material respects because it did not comply with the AICPA quality control standards for the year ended June 30, 19XX."

**Appendix J**

.88

**Guidelines for and Illustration of a Letter of Comments on an Off-Site Peer Review****Guidelines**

1. The objectives of the letter of comments on an off-site peer review are set forth in the Standards. Such letters are expected to be issued on many off-site reviews.

2. The letter should be addressed, dated, and signed in the same manner as the report on the off-site peer review, and should include—

- a. A reference to the report on the review, indicating, where applicable, that the report was qualified or adverse.
- b. A description of the purpose of the off-site peer review.
- c. A statement that the review was performed in accordance with standards established by the Peer Review Board of the AICPA.
- d. The findings on the review and related recommendations. (Those findings, if any, that resulted in a qualified or adverse report and those that did not should be separated in this section. In addition, the letter should identify, where applicable, any comments that were also made in the letter of comments issued on the firm's previous peer review.)
- e. A statement that the matters discussed in the letter were considered in preparing the report.

3. In addition to matters that resulted in a qualified or adverse report, which must always be included in the letter, the letter of comments should include—

- a. Other departures from professional standards that are not deemed to be significant departures but that should be considered by the reviewed firm in evaluating the quality control policies and procedures over its accounting practice.
- b. Instances in which the firm failed to comply with one or more of the membership requirements of the private companies practice section in all material respects, but the instances are not deemed to be significant enough to qualify the report.

**Illustration of a Letter of Comments**

*[State CPA society letterhead for a "CART Review"; firm letterhead for a "Firm-on-Firm Review"; association letterhead for an "Association Review"]*

August 31, 19XX

To the Owners

Able, Baker & Co.

*or*

To John B. Baker, CPA

We have performed an off-site peer review with respect to the accounting practice of *[Name of Firm]* for the year ended June 30, 19XX, in accordance with standards established by the Peer Review Board of the American Institute of Certified Public Accountants, and have issued our report thereon dated August 31, 19XX (which was qualified/adverse\* as described therein). This letter should be read in conjunction with that report.

An off-site peer review consists only of reading selected financial statements and the accountant's compilation or review report thereon for the purpose of considering whether the financial statements appear to be in conformity with generally accepted accounting principles or, if applicable, with an other comprehensive basis of accounting and whether the accountant's report appears to conform with the requirements of professional standards. An off-site peer review does not provide the reviewer with a basis for expressing any assurance as to the firm's quality control policies and procedures for its accounting practice, and we express no opinion or any form of assurance on them. However, the following matters did come to our attention during our review.

*[Following would be a description of—*

- *Matters that resulted in a qualified or adverse report.*
- *Matters that did not result in a qualified or adverse report.]*

The foregoing matters were considered in preparing our report dated August 31, 19XX, and this letter does not change that report.

William Brown, Reviewer

*or*

Jackson & Allen, P.A. *[For review by a firm]*

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\* To be included if the reviewer issues a qualified or adverse report. The wording should be tailored to fit the circumstances.



## Examples of Matters That Might Be Included in Letters of Comments on Off-Site Peer Reviews

### *Matters That Resulted in a Qualified or Adverse Report\**

1. Finding—During our review, we noted that the firm did not qualify its reports on financial statements when neither the financial statements nor the footnotes noted that the statements were presented on a comprehensive basis of accounting other than generally accepted accounting principles.

Recommendation—We recommend that the firm review the reports issued during the last year and identify those reports which should have been modified to reflect a comprehensive basis of accounting other than generally accepted accounting principles. A memorandum should then be prepared highlighting the changes to be made in the current year and placed in the files of the client for whom a report must be changed.

2. Finding—In the engagements that we reviewed, disclosures of related-party transactions and lease obligations as required by generally accepted accounting principles were not included in the financial statements, and the omission was not disclosed in the accountant's reports.

Recommendation—We recommend that the firm review the professional standards governing disclosures of related-party transactions and lease obligations and disseminate information regarding the disclosure requirements to all staff involved in reviewing or compiling financial statements. In addition, we recommend that the firm establish appropriate policies to ensure that all necessary related-party transactions and lease obligations are disclosed in financial statements reported on by the firm. For example, a step might be added to compilation and review work programs requiring that special attention be given to these areas.

3. Finding—During our review of the accountants' reports issued by the firm, we noted numerous instances in which the accompanying financial statements departed from professional standards and on which the accountants' reports was not appropriately qualified. These included the following:

- Failure to disclose material intercompany transactions
- Failure to appropriately recognize revenue
- Failure to present financial statements in a proper format
- Failure to recognize conflicting or incorrect information within the financial statements presented

In one instance, the firm has discussed the departures with its client and decided to recall its report and restate the accompanying financial statements.

Recommendation—We recommend that the firm establish a means of ensuring its compliance with professional standards on accounting engagements. Such means might include continuing professional education in accounting and reporting, use of a reporting and disclosure checklist on accounting engagements, or a "cold" review of reports and financial statements prior to issuance.

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\* This caption is to be used only if a qualified or adverse report has been issued, and it should be tailored to fit the circumstances.

4. *Finding*—On substantially all the engagements that we reviewed, we noted that the firm did not comply with the AICPA Statement on Standards for Accounting and Review Services for reporting on comparative financial statements and going concern issues.

*Recommendation*—We recommend that the firm review the requirements for reporting on comparative financial statements and revise the standard reports used by the firm to conform with these requirements. Also, the firm should review the requirements governing reporting on going concern issues and provide guidance to the staff in this area.

### ***Matters That Did Not Result in a Qualified or Adverse Report\****

5. *Finding*—During our review of computer-generated compiled financial statements prepared by the firm, we noted that the firm failed to indicate the level of responsibility it was taking for supplemental data presented with the basic financial statements.

*Recommendation*—The firm should revise the standard reports used by the firm to conform with professional standards governing reporting on supplemental data presented with basic financial statements.

6. *Finding*—We noted that computer-generated compiled financial statements prepared on a basis of accounting other than generally accepted accounting principles (GAAP) were properly reported on, but they used titles normally associated with a GAAP presentation.

*Recommendation*—The firm should review the professional standards governing the titles to be used when financial statements are prepared on a comprehensive basis of accounting other than GAAP and make sure that the software used by the firm is adjusted to conform with these standards. Until the software is revised, the firm should manually prepare the compiled financial statements in accordance with professional standards.

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\* This caption is to be used only if a qualified or adverse report has been issued, and it should be tailored to fit the circumstances.

**Appendix K**

.89

**Illustration of a Response by a Reviewed Firm to a Letter of Comments on an Off-Site Peer Review**

The purpose of a letter of response is to describe the actions the firm has taken or will take to prevent a recurrence of each matter discussed in the letter of comments. If the reviewed firm disagrees with one or more of the findings or recommendations in the letter of comments, its response should describe the reasons for such disagreement. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see the section of these Standards on "Acceptance of Reviews" [paragraphs .69 through .76]). If the firm has received a qualified or adverse report, the firm's responses should be separated between those findings that resulted in a qualified or adverse report and those that did not.

\* \* \* \*

**Sample Letter of Response**

September 15, 19XX

*[Addressed to the state CPA society administering the review]*

Ladies and Gentlemen:

This letter represents our (my) response to the letter of comments on the off-site peer review of our firm's (my) accounting practice for the year ended June 30, 19XX.

To prevent the recurrence of the disclosure deficiencies noted by the reviewer and to prevent other disclosure deficiencies from occurring, we (I) have obtained copies of the AICPA reporting and disclosure checklists. These checklists will be completed on all review engagements and on all compilation engagements.

We (I) have established procedures to ensure that our (my) reports and the computer-generated compiled financial statements prepared on a basis of accounting other than generally accepted accounting principles reflect the appropriate titles.

We (I) believe these actions are responsive to the findings of the review.

Sincerely,

*[Name of Firm]*

**AICPA Peer Review Board (1993-1994)**  
**(Formerly the AICPA Quality Review Executive Committee)**

JOHN R. BURZENSKI, *Chair*  
HOWARD H. ANDERSON  
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JANET LUALLEN  
*Senior Technical Manager*  
*Peer Review Division*

DALE R. ATHERTON  
*Vice President,*  
*Peer Review*

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\* Consultant.

## PR Section 9000

# INTERPRETATIONS OF STANDARDS FOR PERFORMING AND REPORTING ON PEER REVIEWS

*Interpretations of the Standards for Performing and Reporting on Peer Reviews are developed in open meetings by the AICPA Peer Review Board for peer reviews of firms enrolled in the AICPA peer review program and of members of the private companies practice section. Interpretations of standards need not be exposed for comment and are not the subject of public hearings. These interpretations are applicable to firms enrolled in the peer review program, members of the private companies practice section, individuals and firms who perform and report on peer reviews, state CPA societies that participate in the administration of the program, associations of CPA firms that assist their members in arranging and carrying out peer reviews, and the AICPA Peer Review Division itself.*

*In the fall of 1994, the AICPA Board of Directors and the AICPA Council approved the combination of the peer review program of the private companies practice section and the AICPA quality review program. At that time, the AICPA quality review program was renamed the AICPA peer review program and the executive committee having senior status with authority to establish and conduct the review program in cooperation with state CPA societies was renamed the AICPA Peer Review Board. The Standards for Performing and Reporting on Peer Reviews were formerly called the Standards for Performing and Reporting on Quality Reviews.*

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**PR Section 9100*****Standards for Performing and Reporting on Peer Reviews: Peer Review Interpretations of PR Section 100*****1. Reviews of Sole Practitioners Who Audit Historical or Prospective Financial Statements**

**.01** *Standards for Performing and Reporting on Peer Reviews* (*Standards* [section 100]) require firms that perform audits of historical or prospective financial statements to have on-site peer reviews [section 100.04]. The review should provide the reviewer with a reasonable basis for expressing an opinion on whether during the year under review the reviewed firm's system of quality control for its accounting and auditing practice met the objectives of quality control standards established by the AICPA and was being complied with in order to provide the reviewed firm with reasonable assurance of conforming with professional standards.

**.02** To achieve those objectives, the reviewer is required to test administrative and personnel files; review selected engagements, including the relevant working paper files and reports; interview firm personnel; access other evidential matter, as appropriate; and communicate his or her conclusions to senior members of the reviewed firm at an exit conference. It was contemplated that these procedures would be performed in the most practicable, cost-effective manner during a visit to the reviewed firm and, thus, the term "on-site peer reviews" was used in the *Standards* [section 100]. However, many sole practitioners believe that their reviews could be carried out at less cost if they were permitted to send the required files, reports, and other evidential matter to the reviewer.

**.03** A review conducted at the reviewer's office or another agreed-upon location can achieve the objectives of an on-site peer review and can be described as such in the reviewer's report provided that (1) the reviewed firm is a sole practitioner with four or fewer professional staff; (2) the sole practitioner holds one or more meetings, by telephone or in person, with the reviewer to discuss the firm's responses to the quality control policies and procedures questionnaire, engagement finding, and the reviewer's conclusions on the review; (3) provided the sole practitioner did not receive a qualified or adverse report on the firm's last committee accepted on-site or off-site peer or quality review (effective for reviews performed on or after April 1, 1996); and (4) in addition to materials outlined in the "Instructions to Firms Having an On-Site Peer Review" (see PRP section 4100.07), the sole practitioner sends the following materials to the reviewer prior to the review:

- a. All documentation related to the resolution of independence questions (a) identified during the year under review with respect to any audit or accounting client or (b) related to any of the audit or accounting clients selected for review, no matter when the question was identified if the matter still exists during the review period.
- b. The most recent independence confirmations received from other firms of CPAs engaged to perform segments of engagements on which the sole practitioner acted as principal auditor or accountant.

- c. The most recent representations received from all professional staff concerning their compliance with applicable independence requirements.
- d. Documentation, if any, of consultations with outside parties during the year under review in connection with audit or accounting services provided to any client.
- e. A list of relevant technical publications used as research materials, as referred to in questions B.4 and C.7 of the questionnaire (see PRP sections 4200.03.B.4 and 4300.03.C.7).
- f. A list of audit and accounting materials, if any, identified in response to the questions in the "Supervision" section of the questionnaire (see PRP sections 4200.03.C and 4300.03.D).
- g. Continuing professional education (CPE) records sufficient to demonstrate compliance by the CPAs in the firm with state and AICPA CPE requirements.
- h. The relevant working paper files and reports on the engagements selected for review.
- i. Any other evidential matter requested by the reviewer.
- j. Documentation of compliance with the membership requirements of the private companies practice section (if applicable).

.04 In the event that deficiencies are noted during the review of selected engagements, the scope of the review may have to be expanded before the review can be completed.

.05 A sole practitioner and the reviewer should mutually agree on the appropriateness and efficiency of this approach to the peer review.

[Issue Date: January, 1990; Amended: May, 1992;

Amended: October, 1994; Amended: May, 1995.]

## **2. Selection in On-Site Peer Reviews of ERISA and Depository Institution Audit Engagements**

.06 *Question*—During the 1990s, regulators and legislators focused attention on the quality of audits conducted by CPA firms. If a firm performs an audit pursuant to the Employee Retirement Income Security Act of 1974 (ERISA) or an audit of a depository institution subject to the Federal Deposit Insurance Corporation Improvement Act of 1991 (the Act), should such engagements be selected for review in an on-site peer review?

.07 *Interpretation*—The *Standards for Performing and Reporting on Peer Reviews* (Standards [section 100]) require that the engagements selected for review in an on-site peer review provide a reasonable cross section of the reviewed firm's accounting and auditing practice and that greater weight be given to audit engagements that meet the following criteria:

- a. Engagements in which there is a significant public interest, such as publicly held clients, financial and lending institutions, and brokers and dealers in securities.
- b. Engagements in other specialized industries.
- c. Engagements that are large, complex, or high-risk or that are the reviewed firm's initial audits of clients.

In addition, the *Standards* require that the sample of engagements include at least one audit conducted pursuant to *Government Auditing Standards* issued by the U.S. General Accounting Office [section 100.41-.42].



.08 In selecting engagements for review, the reviewer should consider whether "high-risk" engagements and engagements with a "significant public interest" have been identified by the firm as a result of the application of its quality control policies and procedures on, for example, acceptance and continuance of clients, supervision, or consultation. The reviewer should also consider whether certain industries represented in the reviewed firm's accounting and auditing practice should be given greater weight in the engagement selection process because engagements in those industries pose a higher risk because of economic or business conditions or because there is a significant public interest in those engagements as evidenced by, for example, regulatory or legislative requirements or developments. The reviewer should also consider requirements that may have been published by regulatory agencies with respect to the peer review process.

.09 Regulatory and legislative developments during 1990 have made it clear that there is a significant public interest in audits conducted pursuant to ERISA. Accordingly, greater weight should be given in the engagement selection process on on-site reviews to those audits if the firm performs such engagements.

.10 The 1993 Federal Deposit Insurance Corporation (FDIC) guidelines implementing the FDIC Improvement Act of 1991 require auditors of federally insured depository institutions with more than \$500 million in total assets to have a peer review that includes the review of at least one audit of an insured depository institution subject to the Act. If a firm performs an audit of a federally insured depository institution subject to the Act and the peer review is intended to meet the requirements of the Act, at least one engagement conducted pursuant to the Act should be selected for review. The review of that engagement should include a review of the reports on internal control or compliance with laws and regulations since those reports are required to be issued under the Act.

[Issue Date: December, 1990; Amended: October, 1993;

Amended: October, 1994.]

### **3. Reviewer Qualifications: Association With a Firm That Had an Unqualified Review Within the Previous Three Years**

.11 *Question*—If a reviewer's firm has not had a review within the previous three years because the firm's review was postponed by the administering entity or the firm was assigned a due date beyond the three-year period for its subsequent review, is the reviewer permitted to serve as a team captain on an on-site peer review or as a reviewer on an off-site peer review?

.12 *Interpretation*—The *Standards for Performing and Reporting on Peer Reviews* [section 100.18 and .21] require that a team captain be associated with a firm that has received an unqualified report on its system of quality control within the previous three years.

.13 In rare circumstances, reviews may be postponed as the result of a request by the AICPA or another administering entity to balance its administrative workload. In such circumstances, the requirement that a reviewer's firm must have a review within the previous three years may be waived for a period of time equal to the length of the postponement provided that (1) all of the other requirements for service as a team captain on an on-site peer review or as a reviewer on an off-site peer review are met and (2) the firm's most recent review resulted in an unqualified report or a report not adverse or qualified for significant departures from professional standards on an off-site peer review.

.14 Similarly, if a firm is assigned a due date beyond the three-year period for its subsequent review, the requirement that a reviewer's firm must have a review within the previous three years will be waived for a period of time up to the due date assigned for the subsequent review provided that (1) the due date assigned is not beyond three years and six months after the end of the period covered by the previous peer or quality review and (2) the firm's most recent review resulted in an unqualified report or a report not adverse or qualified for significant departures from professional standards on an off-site peer review.

[Issue Date: June, 1991; Amended: January, 1994; Amended: October, 1994.]

#### **[4.] Requirements for Off-Site Reviews Conducted by Members of Associations of CPA Firms**

[.15—.18] [Deleted January, 1994.]

#### **[5.] Off-Site Reviewer Qualifications: Effect of a Firm's Review Status**

[.19—.23] [Deleted January, 1994.]

#### **[6.] Off-Site Reviewer Qualifications: Performance of Firm-on-Firm Off-Site Reviews**

[.24—.25] [Deleted January, 1994.]

### **7. Selection of SEC Engagements in On-Site Peer Reviews**

.26 *Question*—Firms that audit one or more SEC clients as defined by Council in an implementing resolution under bylaw section 2.3.5 [BL section 230R.08] may enroll in the peer review program or the private companies practice section only when they have resigned, declined to stand for re-election, or been dismissed as auditor of all such clients. In that event, should one or more of such engagements be selected for review in the firm's on-site peer review?

.27 *Interpretation*—The *Standards for Performing and Reporting on Peer Reviews* [section 100] states that "greater weight should be given to audit engagements...in which there is a significant public interest, such as publicly held clients, financial and lending institutions, and brokers and dealers in securities." This guidance applies to all SEC audit engagements carried out during the year under review, whether or not the entities involved remain clients of the firm.

.28 In addition, the reviewer should satisfy himself or herself that the SEC has been notified by appropriate filings of Forms 8-K that the firm has resigned, declined to stand for re-election, or been dismissed as auditor of the SEC clients that were clients at any time since the date of the firm's last peer review or during the year under review if the reviewed firm has not previously had a review.

[Issue Date: May, 1992; Amended: October, 1994.]

### **8. Reviewer Experience Requirements**

.29 *Question*—The *Standards for Performing and Reporting on Peer Reviews (Standards)*, paragraph 17 [section 100.17], states that "an individual serving as a reviewer (whether for on-site or off-site peer reviews) must be a member of the AICPA licensed to practice as a certified public accountant, must possess current knowledge of applicable professional standards, and must be currently active in public practice at the supervisory level in the accounting or auditing function of a firm enrolled in an approved practice-monitoring program." What do the *Standards* [section 100] mean by "possess current

knowledge of professional standards” and “currently active in....auditing function?”

**.30 Interpretation**—Footnote 5 to paragraph 18 of the *Standards* [section 100.18] states that the standard set forth in paragraph 18 [section 100.18] “is not intended to require that reviewers spend all their time on accounting and auditing engagements” and that reviewers “should carefully consider whether their day-to-day involvement in accounting and auditing work is sufficiently comprehensive to enable them to perform a peer review with professional expertise.”

**.31** A reviewer would be considered “currently active in....auditing function” if he or she is currently involved in the auditing practice of his or her firm either supervising one or more of the firm’s audit engagement teams or carrying out a quality control/review function on the firm’s audit engagements.

**.32** For a reviewer to be considered to have “current knowledge of applicable professional standards,” he or she should also be knowledgeable about current rules and regulations applicable to the industries he or she reviews. Such knowledge may be obtained from training courses, on-the-job training, or a combination of both.

**.33** Because some industries are high-risk and complex, they require a higher level of knowledge and recent practice experience. Therefore, if a reviewer does not have recent practice experience in such an industry, the reviewer may be called upon to justify why he or she should be permitted to review engagements in that industry.

**.34** The entity administering the review has the authority to decide whether a reviewer’s experience is sufficient to perform a particular review.

[Issue Date: September, 1992; Amended: October, 1994.]

## **9. Reviewer Qualifications: Association With a Firm That Has Had a Review**

**.35 Question**—Paragraph 17 of the *Standards for Performing and Reporting on Peer Reviews* (*Standards* [section 100.17]) states that an individual serving as a reviewer (whether for on-site or off-site peer reviews) “must be currently active in public practice at a supervisory level in the accounting or auditing function of a firm enrolled in an approved practice-monitoring program as... (a) an owner of the firm” or “(b) a manager or person with equivalent supervisory responsibilities.” Paragraph 18 of the *Standards* [section 100.18] further states that “a team captain must also be associated with a firm that has received an unqualified report on its system of quality control within the previous three years.” Similarly, paragraph 21 of the *Standards* [section 100.21] states that “off-site reviewers must also be associated with a firm that has received, within the three previous years, either of the following:

- a. An unqualified report on its system of quality control.
- b. A report on an off-site review that is not adverse or qualified for significant departures from professional standards.”

If a reviewer is associated with more than one firm as an owner, manager, or person with equivalent supervisory responsibilities, must each of the firms with which the reviewer is associated comply with these requirements?

**.36 Interpretation**—If a team captain on an on-site peer review or an individual conducting an off-site peer review is associated with more than one firm, all of those firms subject to an on-site review or an off-site review must not have received an adverse report, or a report qualified for its system of

quality control or qualified for significant departures from professional standards.

[Issue Date: February, 1995; Amended: May, 1995.]

#### **10. Reviewer Qualifications: Association With Newly Formed Firms**

**.37 Question**—Paragraph 18 of the *Standards for Performing and Reporting on Peer Reviews* (the *Standards* [section 100.18]), states that "a team captain must also be associated with a firm that has received an unqualified report on its system of quality control within the previous three years." Paragraph 21 of the *Standards* [section 100.21] states that "off-site reviewers must also be associated with a firm that has received, within the three previous years, either of the following:

- a. An unqualified report on its system of quality control
- b. A report on an off-site review that is not adverse or qualified for significant departures from professional standards."

If an individual starts or joins a newly formed firm, which has never been peer reviewed, can the individual continue to conduct on-site and off-site peer reviews until his or her new firm is peer reviewed?

**.38 Interpretation**—An individual who was previously associated with a firm that received an unqualified report on its system of quality control that starts or joins a newly formed firm will be deemed to be in compliance with the paragraph 18 [section 100.18] requirement described above and may serve as a team captain on-site peer reviews during the twelve-month transitional period beginning with the date the individual disassociates from his or her previous firm, provided the individual possesses all of the other qualifications for service as an on-site peer review team captain. Similarly, an individual conducting off-site peer reviews is deemed to be in compliance with the paragraph 21 [section 100.21] requirement set forth above during the twelve-month transitional period beginning with the date the individual disassociates from his or her previous firm, provided the individual possesses all of the other qualifications for service as an off-site reviewer.

[Issue Date: October, 1995.]

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